MONETARY POLICY STATEMENT

PRESS CONFERENCE

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Good afternoon, the Vice-President and I welcome you to our press conference.

The rebound phase in the recovery of the euro area economy is increasingly advanced. Output is expected to exceed its pre-pandemic level by the end of the year. With more than 70 per cent of European adults fully vaccinated, the economy has largely reopened, allowing consumers to spend more and companies to increase production. While rising immunity to the coronavirus means that the impact of the pandemic is now less severe, the global spread of the Delta variant could yet delay the full reopening of the economy. The current increase in inflation is expected to be largely temporary and underlying price pressures are building up only slowly. The inflation outlook in our new staff projections has been revised slightly upwards, but in the medium term inflation is foreseen to remain well below our two per cent target.

Financing conditions for firms, households and the public sector have remained favourable since our previous quarterly assessment in June. Favourable financing conditions are essential for the economy to continue its recovery and to offset the negative impact of the pandemic on inflation.

Based on a joint assessment of financing conditions and the inflation outlook, the Governing Council judges that favourable financing conditions can be maintained with a moderately lower pace of net asset purchases under the pandemic emergency purchase programme (PEPP) than in the previous two quarters.

We also confirmed our other measures, namely the level of the key ECB interest rates, our forward guidance on their likely future evolution, our purchases under the asset purchase programme (APP), our reinvestment policies and our longer-term refinancing operations, as detailed in the press release published at 13:45 today. We stand ready to adjust all of our instruments, as appropriate, to ensure that inflation stabilises at our two per cent target over the medium term.

I will now outline in more detail how we see the economy and inflation developing, and then talk about our assessment of financial and monetary conditions.

Economic activity

The economy rebounded by 2.2 per cent in the second quarter of the year, which was more than expected. It is on track for strong growth in the third quarter. The recovery builds on the success of the vaccination campaigns in Europe, which have allowed a significant reopening of the economy.

With the lifting of restrictions, the services sector is benefiting from people returning to shops and restaurants and from the rebound in travel and tourism. Manufacturing is performing strongly, even though production continues to be held back by shortages of materials and equipment. The spread of the Delta variant has so far not required lockdown measures to be reimposed. But it could slow the recovery in global trade and the full reopening of the economy.

Consumer spending is increasing, although consumers remain somewhat cautious in the light of the pandemic developments. The labour market is also improving rapidly, which holds out the prospect of higher incomes and greater spending. Unemployment is declining and the number of people in job retention schemes has fallen by about 28 million from the peak last year. The recovery in domestic and global demand is further boosting optimism among firms, which is supporting business investment.

At the same time, there remains some way to go before the damage to the economy caused by the pandemic is overcome. There are still more than two million fewer people employed than before the pandemic, especially among the younger and lower skilled. The number of workers in job retention schemes also remains substantial.

To support the recovery, ambitious, targeted and coordinated fiscal policy should continue to complement monetary policy. In particular, the Next Generation EU programme will help ensure a stronger and uniform recovery across euro area countries. It will also accelerate the green and digital transitions, support structural reforms and lift long-term growth.

We expect the economy to rebound firmly over the medium term. Our new staff projections foresee annual real GDP growth at 5.0 per cent in 2021, 4.6 per cent in 2022 and 2.1 per cent in 2023. Compared with our June staff projections, the outlook has improved for 2021 and is broadly unchanged for 2022 and 2023.

Inflation

Inflation increased to 3.0 per cent in August. We expect inflation to rise further this autumn but to decline next year. This temporary upswing in inflation mainly reflects the strong increase in oil prices since around the middle of last year, the reversal of the temporary VAT reduction in Germany, delayed summer sales in 2020 and cost pressures that stem from temporary shortages of materials and equipment. In the course of 2022 these factors should ease or will fall out of the year-on-year inflation calculation.

Underlying inflation pressures have edged up. As the economy recovers further, and supported by our monetary policy measures, we expect underlying inflation to rise over the medium term. This increase is expected to be only gradual, since it will take time for the economy to return to operating at full capacity, and therefore wages are expected to grow only moderately. Measures of longer-term inflation expectations have continued to increase, but these remain some distance from our two per cent target.

The new staff projections foresee annual inflation at 2.2 per cent in 2021, 1.7 per cent in 2022 and 1.5 per cent in 2023, being revised up compared with the previous projections in June. Inflation excluding food and energy price inflation is projected to average 1.3 per cent in 2021, 1.4 per cent in 2022 and 1.5 per cent in 2023, also being revised up from the June projections.

Risk assessment

We see the risks to the economic outlook as broadly balanced. Economic activity could outperform our expectations if consumers become more confident and save less than currently expected. A faster improvement in the pandemic situation could also lead to a stronger expansion than currently envisaged. If supply bottlenecks last longer and feed through into higher than anticipated wage rises, price pressures could be more persistent. At the same time, the economic outlook could deteriorate if the pandemic worsens, which could delay the further reopening of the economy, or if supply shortages turn out to be more persistent than currently expected and hold back production.

Financial and monetary conditions

The recovery of growth and inflation still depends on favourable financing conditions for all sectors of the economy. Market interest rates have eased over the summer, but reversed recently. Overall, financing conditions for the economy remain favourable.

Bank lending rates for firms and households are at historically low levels. Lending to households is holding up, especially for house purchases. The somewhat slower growth of lending to firms is mainly due to the fact that firms are still well funded, because they borrowed heavily in the first wave of the pandemic. They have high cash holdings and are increasingly retaining earnings, which reduces the need for external funding. For larger firms, issuing bonds is an attractive alternative to bank loans. Solid bank balance sheets continue to ensure that sufficient credit is available.

However, many firms and households have taken on more debt during the pandemic. A deterioration in the economic outlook could threaten their financial health. This, in turn, would worsen the quality of banks' balance sheets. Policy support remains essential to prevent balance sheet strains and tightening financing conditions from reinforcing each other.

Conclusion

Summing up, the euro area economy is clearly rebounding. However, the speed of the recovery continues to depend on the course of the pandemic and progress with vaccinations. The current rise in inflation is expected to be largely temporary and underlying price pressures will build up only gradually. The slight improvement in the medium-term inflation outlook and the current level of financing conditions allow favourable financing conditions to be maintained with a moderately lower pace of net asset purchases under the PEPP. Our policy measures, including our revised forward guidance on the key ECB interest rates, are key to helping the economy shift to a sustained recovery and, ultimately, to bringing inflation to our two per cent target.

We are now ready to take your questions.

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I had two questions. The first was on the pace, on the discussion around reducing asset purchases. Some of your Council members have suggested that they would like to see the programme, the Pandemic Emergency Purchasing Programme (PEPP) coming to an end soon. Would you characterise this, or did you characterise this internally, as a taper, or is it a turning point, or how would you characterise the move? And the second question was, why you feel

confident enough to do this? Your 2023 outlook for inflation is 1.5 per cent, which is some way below your medium-term target. There also seems to be a lot of uncertainty in the global economy around Delta, around slowdown in China. So, why did you think reducing your stimulus was the correct move? Thank you.

Lagarde: Well, thank you so much for your questions. I would preface my response to your first question by a quote, actually, in a way, which is, the lady isn't tapering. Because what we are doing is recalibrating PEPP, which I'll remind you is the Pandemic Emergency Purchase Programme, and we are recalibrating just as we did back in December and back in March. We are doing that on the basis of the framework, which is a joint assessment, so we look at the financing conditions, and we concluded that they remain favourable, and we do that on the basis on the inflation outlook. And as you rightly pointed out, our inflation outlook has been upgraded, and it has been the case for '21, significantly, '22, quite significantly, and to a lesser extent, '23. But across the board, you have an improvement on the inflation numbers for the whole horizon that we look at. We also look at other indicators, and on those accounts as well, there has been a significant improvement of the inflation numbers, both for '22 and '23. So, on the basis of that joint assessment, and because we know that we need to keep favourable financing conditions, this is the commitment that we have and this is what we agreed in December. That hasn't varied. We believe that we can maintain those favourable financing conditions with a moderately lower pace of purchase, and, of course, the choice of words is relevant. It is moderately lower than what we have done in Q2 and Q3. Are we confident enough? Well, you know, the September meeting is conducted in the light of our projections, and what we are seeing is clearly an improvement on many fronts. The output numbers are much higher. The inflation numbers have been upgraded as I've just indicated. The employment numbers have also improved and the unemployment situation is serious, of course, but more benign than was anticipated. So, on the basis of all that, and the success of the vaccination campaign, which we have all along said was critically important to determine the economic recovery, we believe that the euro area economy is rebounding. And that gives us the confidence to take the measure that we have taken, which, as I said, is a recalibration of our Pandemic Emergency Purchase Programme for the next three months.

Thank you for the opportunity, and nice to see you on Webex. President Lagarde, I have two questions. My first question is on financing conditions. For how long will the ECB preserve favourable financing conditions, to support the recovery? Also after the COVID crisis, in a sense, will favourable financing conditions end with the end of the Pandemic Emergency Purchase Programme? And my second question is on PEPP. As the Coronavirus crisis enters a new phase as you have described, with the new Delta variant, but also a better economic outlook and a good pace of vaccinations, can you tell us a bit more how the Governing Council intends to judge and assess the end of the COVID crisis phase, given that PEPP will end when the COVID crisis phase is over? Thank you.

Lagarde: Well, thank you very much, and it's very nice to see you as well. This is a significant improvement from previous press conferences, so we're probably heading in the right direction here. The next step will be to actually see each other with appropriate distance between us. On the commitment for favourable financing conditions, I'll remind you that that was decided at our Governing Council meeting in December, under the auspices of the PEPP. So PEPP is an emergency